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**TO:** Nancy Lund **DATE:** February 26, 1993

**FROM:** Marketing Information & Analysis / Andrew Schwartz

**SUBJECT:** RJR Buy Down - Fresno, California

This analysis details an alternative retail buy down/price segmentation strategy employed by RJR in Fresno, California during 1992. The RJR program in Fresno offers an interesting contrast with Marlboro's execution in the Portland test market.

A market check of the local Fresno area was conducted in late October, 1992. The primary purpose of that visit was to determine RJR's $0.50/pack and $5.00/carton retail buy down tactics, logistics, strategies and objectives. Camel, Winston and Salem had been available at reduced prices in selected retail Fresno outlets since April 1992.

## SUMMARY

Admittedly, the following analysis is based upon observation, inference, field reports and interviews with affected store owners, wholesalers and consumers. Nevertheless, all sources seem to be pointing to the following conclusions:

- RJR is capitalizing on a volume shifting strategy designed to siphon off price sensitive smokers in a cost effective manner. Reynolds' appears to be segmenting demand by attracting price sensitive smokers into hand picked stores in Fresno.
- High volume/pack/Independent stores characterize RJR's selection pattern in Fresno, implying a store volume strategy in which increased volumes attempt to offset lower margins for RJR. RJR's strategy in Fresno appears to have spread as a model to other markets across the U.S. PM Region Highlight reports and recent market checks reference many instances of both buy down and on-pack price reductions for Camel, Winston and Salem.
- Marlboro performance appears to have been adversely impacted in Fresno stores featuring the buy down on Camel, Winston and Salem. Attempts to reconstruct Marlboro share interaction through store invoices proved inconclusive.

Please note that buy down stores are atypical of the Fresno market as they attract and serve a highly promotional responsive smoker segment. It is important to note that smokers taking advantage of RJR's buy down appear drawn from all demographic segments and economic levels based upon consumer intercepts, appearance and the automobile driven to the store. What they have in common is a willingness to travel for a good deal on cigarettes.

## RJR's BUY DOWN BENEFITS

The Fresno buy down seems to have supplemental benefits for RJR beyond the substantial volume increases noted for Camel, Winston and Salem in affected outlets.

By displacing PM inventory and commanding up to 75% of back room stock, potentially:

- PM sell-in initiatives like Summer Special, Medium 100s, Marlboro 5 pack, Masters volume increases and Merit Ultima are restrained by excess RJR inventories. Fresno Field Sales has indicated that RJR's pre-booked volume has kept them from achieving objectives in affected stores.

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Source: https://www.industrydocuments.ucsf.edu/docs/tnvy0004

- Conversion and stronger alternate purchasing for RJR's brands are also more likely through extended repeat purchase.

- Excess Reynolds' inventory may have lowered their OOS rates and raised PM OOS.

In addition to regular retailer margins, supplemental benefits to store owners include: an estimated 25-30% in store volume increase and extra profit on pre-booked product when prices are increased. These benefits serve to build Reynolds' relationship with store owners and may eventually lead to rack or OHPM swaps for RJR fixtures.

## OPTIONS FOR DISCUSSION

Marlboro's potential share exposure in affected Fresno accounts and evidence that similar price reductions have surfaced in other markets suggests that options for a sustainable defense should be considered and evaluated.

Defensive options might include:

- Meet competition via price reduction or product offers on Marlboro or Other PM Premium brands in **selective** stores where our position has been weakened by the RJR buy down.

- Inform other Wholesalers, Pack outlets and Chains who are not being offered RJR's selective deals that they are bearing a competitive disadvantage. If RJR is forced to extend their offer to more outlets, this could serve to raise their funding levels and decrease volume response to below profitable levels.

- Initiate cease and desist communications to RJR Legal.

- Advise local Fair Trade Councils about RJR's selective activities.

## FINDINGS

- RJR has primarily selected Independently owned, high volume, pack outlets (800+ CPW) to reduce the pack or carton price of Winston, Camel and Salem by $0.50/pack or $5.00/carton. The situation is comparable to Con Edison or AT&T's time of day discounts for shifting consumption to evenings and weekends. What these companies have achieved with demand shifting based upon time of day, RJR has achieved by pulling price sensitive smokers cross town to selected outlets for the best cigarette deals in Fresno.

- RJR's Full margin price relief efficiently reaches a highly promotional responsive smoker audience, in a contained environment while providing a full array of **acceptable Premium:** tar, length & flavor options to young adult (Camel), older (Winston) and menthol smokers (Salem).

- Camel, Winston and Salem ($1.39) were selling 27% below Marlboro's pack price ($1.89) in buy down outlets. The cheapest Black & White/PL brands in these stores ($0.99) were selling at a 48% discount to Marlboro and 29% below RJR's core Premium brands on deal.

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- High volume/pack/Independent stores characterize RJR's selection pattern, implying a store volume strategy in which increased volumes attempt to offset lower margins for RJR. RJR's strategy in Fresno appears to have spread as a model to other markets across the U.S. In some markets, on-pack coupons have replaced buy down funds.

- The longevity of the buy down store's low price positioning in conjunction with word of mouth and exterior signage has reinforced the consumer benefit for Fresno smokers, changing promotionally driven outlet shifting into regular purchase behavior.

- High volume, Independently owned, pack outlets are an unusual combination of store attributes. In Fresno, these accounts were often hybrid Liquor/C-stores. Typically, high volume stores tend to be carton driven and/or Chain owned. RJR seems to have avoided buy down placements in high volume Chain accounts to minimize demands for access to funding requests for all stores within the chain.

  Where RJR's buy down store placements did not fit "the pattern" in Fresno, additional probing revealed that these stores tended to be "me-too" outlets in close proximity to participating stores which complained loudly enough to receive comparable deals.

- Based upon conversations with store owners and field personnel, most outlets participating in the RJR buy down appear to have had a volume strategy before the program began. RJR's initiative served to reinforce participating Independent retailers positioning, offering the best cigarette deals in town.

## IMPACT ON MARLBORO

Observations in the largest pack stores with a buy down (1000+ CPW) suggest that RJR had adversely impacted Marlboro in Fresno stores featuring the buy down on Camel, Winston and Salem. Attempts to reconstruct Marlboro share interaction through store invoices proved inconclusive.

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## RJR BUY DOWN LOGISTICS

RJR reps are guaranteeing the buy down on pre-booked quantities from 200+ cartons in any mix of Camel, Winston and Salem. Participating retailers indicated that they essentially could pre-book as much as they could handle and that the total buy down has been uniformly $5 in cash, check or coupon combination since the program began. RJR reps indicated to retailers that the buy down will continue at least through the end of 1992. The following steps seem to characterize RJR's buy down execution:

- RJR rep pre-books inventory. No retailer reported reaching any pre-book limits. There were no retail terms offered on the extra volume and payment is expected when the volume is delivered to the store.

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Source: https://www.industrydocuments.ucsf.edu/docs/tnvy0004

- Hing Kee Co., located in Fresno, appears to be a primary conduit for tax stamping volume associated with this program. Hing Kee is carried on SPACE as a wholesale distributor servicing 4 stores with total CPW of 265 . Conversations with the owner suggest that his volume is actually 12,000 CPW, an +8,535 CPW increase (+343%) since RJR' S program began. Hing Kee indicated that he does not co-fund any portion of the buy down money in exchange for this volume windfall and does not have to lay out any funds to finance this volume. His financial incentive was cited as purely handling and stamping the extra volume.

- Despite a delivery service for existing accounts, Hing Kee does not deliver any pre-booked product. When asked about this, Hing Kee cited fear of such large accounts receivable from Independents and suggested that one bad check could put his small operation out of business. The extra volume is paid for and personally delivered to participating stores by an RJR rep.

- Product is delivered via RJR rep van , the retailer cuts a check as payment in full and the RJR rep gives the retailer the cash/check/coupon equivalent of $5 per carton.

- All participating retailers visited were passing the full buy down on to consumers. Participating stores stand to earn their regular margins on pre-booked product as it is sold while benefiting from an estimated 25-30% store volume increase from access to bought down cigarettes.

Fleming Foods is the only other distributor in Fresno and claimed no participation or knowledge of the RJR program. Fleming primarily services Supermarkets and Grocery Stores, while Hing Kee' s only business is pack oriented Independent accounts. Hing Kee, a small operation owned and operated by a husband and wife team, represents an environment more easily controlled and contained by RJR.

## DISTRIBUTOR RESPONSE

Some of the volume diverted through Hing Kee Co. was gained at the expense of other wholesalers who used to service the affected stores. Modesto Tobacco, is believed to have serviced some of the buy down accounts. Based upon field reports, when wholesalers losing business to Hing Kee were contacted regarding volume lost from the buy down, RJR activity temporarily subsided.

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